

Message Text

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INFO OCT-01 EA-09 NEA-10 IO-13 ISO-00 EURE-00 SSO-00
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AID-05 EB-07 FRB-01 XMB-04 OPIC-06 CIEP-02 LAB-04
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DEPARTMENT PASS FEDERAL RESERVE BOARD

TREASURY FOR DONALD E. SYVRUD, OASIA

E.O. 11652: N/A
TAGS: ECON, UK
SUBJECT: ECONOMIC DEVELOPMENTS FOR PERIOD DECEMBER 16-22

SUMMARY: WITH THE UNVEILING OF THE LONG-AWAITED ECONOM-
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IC PACKAGE, MUCH COMMENT WAS DEVOTED TO ITS MACROECONOMIC
IMPACT. ECONOMIC INDICATORS CONTINUED TO POINT TO THE
SOFTNESS IN THE ECONOMY AS BOTH UNEMPLOYMENT AND RETAIL
PRICES ROSE WHILE GDP REMAINED UNCHANGED IN THE 3RD QUAR-
TER. MONEY SUPPLY FIGURES THROUGH MID NOVEMBER BEGAN TO
REFLECT RECENT HEAVY SALES OF GOVERNMENT DEBT. END SUMMARY

1. CHANCELLOR HEALEY LAID THE MINI-BUDGET, OR THE MEASURES THAT THE UK WILL CARRY OUT IN SUPPORT OF ITS APPLICATION FOR A \$3.9 BILLION CREDIT FROM THE IMF, BEFORE PARLIAMENT ON DECEMBER 15. EXPENDITURE CUTS OF 1 BILLION POUNDS CONTRIBUTE TO A REDUCTION OF 1.8 BILLION POUNDS IN THE PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) PLANNED FOR THE 1977/78 FINANCIAL YEAR. EXPENDITURE CUTS OF 1.5 BILLION POUNDS IN 1978/79 ARE COUPLED WITH A PSBR REDUCTION OF 3 BILLION POUNDS. TARGETS FOR THE GROWTH IN LIQUIDITY WERE ALSO STATED, BUT IN TERMS OF DOMESTIC CREDIT EXPANSION RATHER THAN IN TERMS OF M3 GROWTH AS HAD BEEN WIDELY ANTICIPATED. A SWAP ARRANGEMENT WITH GERMANY AND THE US FOR \$850 MILLION WAS ANNOUNCED AS A SUPPORT FOR THE PROGRAM. THE CHANCELLOR TOOK THE OCCASION TO RELEASE A SUMMARY OF H.M. TREASURY'S FORECAST FOR THE BRITISH ECONOMY IN 1977 UNDER THE CONDITIONS SPECIFIED IN THE MINI-BUDGET. THE FORECAST SEES REAL GDP GROWING AT 2 PERCENT, EXPORT VOLUME AT 8-1/2 PERCENT AND IMPORT VOLUME AT 1-1/2 PERCENT, AND A CURRENT ACCOUNT DEFICIT IN CURRENT PRICES OF 1-1/2 BILLION POUNDS IN 1977. (SEE REPORTS IN LONDON 20283, 20291, 20293, 20294.)

2. PARLIAMENTARY COMMITTEE EXAMINES HEALEY'S PACKAGE

THE EXPENDITURE COMMITTEE OF THE HOUSE OF COMMONS USED AN ANALYSIS OF HMG'S ECONOMIC STRATEGY PREPARED BY TERRY WARD, THE COMMITTEE'S PART-TIME ECONOMIC ADVISER FROM CAMBRIDGE UNIVERSITY, IN QUESTIONING HMTREASURY WITNESSES. WARD'S ANALYSIS CONCLUDED THAT THE PACKAGE AN-

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NOUNCED BY THE CHANCELLOR WOULD INCREASE UNEMPLOYMENT BY 150 THOUSAND IN FY77 AND A FURTHER 250 THOUSAND IN FY78 WITH THE JOBLESS FIGURE POSSIBLY EXCEEDING 2 MILLION BY 1980. WARD ARGUED THAT IN FIXING A PUBLIC SECTOR BORROWING REQUIREMENT TARGET, UNEMPLOYMENT MUST ASSUME THE BURDEN OF ADJUSTMENT. WITH LOWER GROWTH FORECAST OVER THE NEXT TWO YEARS AND DEMOGRAPHIC FORCES ADDING 150,000 PEOPLE A YEAR TO THE LABOR FORCE OVER THE NEXT 5 YEARS, WARD CONCLUDES THAT UNEMPLOYMENT MUST RISE.

REPLYING TO THE WARD CRITIQUE, JOEL BARNETT, CHIEF SECRETARY OF THE TREASURY, CHALLENGED WARD'S FIGURES ON PROBABLE GROWTH RATES AND PRODUCED ESTIMATES THAT, WITH THE CHANCELLOR'S EMPLOYMENT MEASURES, THE TOTAL NUMBER OF

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PEOPLE IN EMPLOYMENT WOULD RISE BY 10,000 IN 1977. BAR-
NETT DID ADMIT THAT THE PACKAGE WOULD ADD A FURTHER 100,000
TO THE UNEMPLOYED IN 1978.

3. UNEMPLOYMENT

AFTER FAILING TO COMPILE NOVEMBER FIGURES BECAUSE OF
AN INDUSTRIAL DISPUTE, THE DEPARTMENT OF EMPLOYMENT
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MANAGED TO PRODUCE A TRUNCATED VERSION OF ITS MONTHLY DATA
ON A SEASONALLY ADJUSTED BASIS EXCLUSIVE OF SCHOOL LEAVERS

UK UNEMPLOYMENT STOOD AT 1.330 MILLION IN DECEMBER COMPARED WITH 1.306 MILLION IN OCTOBER. THE RISE OF 24,000 (SUBJECT TO MARGIN OF ERROR OF 20,000 IN EITHER DIRECTION) PUSHED THE JOBLESS RATE UP FROM 5.5 TO 5.6 PERCENT. SINCE DECEMBER 1975, THE NUMBER OF PEOPLE OUT OF WORK ROSE BY 156,000 (5.0 TO 5.6 PERCENT) REACHING THE HIGHEST YEAR-END LEVEL SINCE DECEMBER 1939.

4. RETAIL PRICES

THE RETAIL PRICE INDEX (JANUARY 1974 EQUALS 100) ROSE BY 1.4 PERCENT IN NOVEMBER TO 165.8 FROM 163.5 IN OCTOBER. THE NOVEMBER RISE BROUGHT THE RATE OF INFLATION SINCE NOVEMBER 1975 TO 15.0 PERCENT COMPARED WITH 14.7 A MONTH EARLIER. THE LARGEST INCREASE CAME FROM SEASONAL FOOD PRICES WHICH ROSE BY 4.8 PERCENT. FOOD PRICE INCREASES AS A WHOLE WERE ESTIMATED TO HAVE ACCOUNTED FOR ABOUT 1/3 OF THE NOVEMBER RISE. NOVEMBER MARKED THE 4TH CONSECUTIVE MONTH IN WHICH THE 12-MONTH RATE OF INFLATION HAS RISEN SINCE TOUCHING A LOW OF 12.9 PERCENT IN JULY. THE COMING MONTHS WILL SEE FURTHER RISES IN THE ANNUAL RATE AS THE HIGHER WHOLESALE PRICES PRODUCED IN THE WAKE OF THE SLIDE IN STERLING WORK THEIR WAY THROUGH TO THE RETAIL LEVEL.

5. GDP

GROSS DOMESTIC PRODUCT SHOWED LITTLE CHANGE DURING THE 3RD QUARTER. THE OUTPUT BASED MEASURE, THE MOST ACCURATE FOR QUARTER TO QUARTER CHANGES, ROSE 0.3 PERCENT, HAVING BEEN PROVISIONALLY ESTIMATED TO HAVE RISEN BY 0.6 PERCENT. THE EXPENDITURE BASED ESTIMATE ROSE BY 1.5 PERCENT WHILE THE INCOME BASED INDICATOR DECLINED BY 1.6 PERCENT. AVERAGING THE THREE, PRODUCED A COMPROMISE FIGURE UNCHANGED FROM THAT REGISTERED IN THE 2ND QUARTER. THUS IN THE YEAR ENDING SEPTEMBER 1976, GDP ROSE BY 1.6

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PERCENT. THE FOLLOWING TABLE SUMMARIZES THE MOST RECENT DATA: GDP IN 1976

	1970 EQUALS 100			
	EXPENDITURE	INCOME	OUTPUT	AVERAGE
1ST QTR	112.0	108.0	108.1	109.4
2ND QTR	108.4	109.3	107.7	108.5
3RD QTR	110.0	107.6	108.0	108.5

6. THE GROWTH OF THE BROADLY DEFINED MONEY STOCK M3 (SEASONALLY ADJUSTED), DECLINED IN THE REPORTING MONTH ENDED NOVEMBER 17 TO 0.4 PERCENT FROM THE 1.2 PERCENT RECORDED FOR THE MONTH ENDED OCTOBER 20. THIS REPRESENTS AN INCREASE OF 4 PERCENT OVER THE LATEST THREE MONTHS. THE GROWTH OF THE NARROWLY DEFINED MONEY STOCK, M1, ROSE 1.1

PERCENT IN THE MONTH ENDING NOVEMBER 17, COMPARED WITH A DECLINE OF 1.8 PERCENT IN THE MONTH ENDED OCTOBER 20, AND A NET INCREASE OF 1-1/2 PERCENT IN THE LATEST THREE MONTHS THE FIGURES FOR M3 INCLUDE A FOREIGN EXCHANGE COMPONENT, WHICH WILL BE NEGLECTED IN FOLLOWING THE PROGRAM FOR THE IMF, AND WHICH REDUCED THE GROWTH OF M3 BY 94 MIL. POUNDS TO 512 MILLION POUNDS IN NOVEMBER. LOWER GROWTH IN M3 IS WIDELY HELD TO REPRESENT THE SUCCESS OF SELLING GILTS AS THE MEASURES TO IMPOSE SPECIAL RESERVE REQUIREMENTS ON BANKS, KNOWN AS "THE CORSET," WERE NOT ANNOUNCED UNTIL NOVEMBER 18.

7. THE TIMES USED THE MONEY SUPPLY FIGURES TO CALCULATE THE LEVEL OF DOMESTIC CREDIT EXPANSION FOR THE FIRST 7

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MONTHS OF THE BANKING YEAR AS 5.9 BILLION POUNDS. THIS WOULD LEAVE 3.1 BILLION POUNDS FOR THE REMAINING 5 MONTHS IF THE TARGETS STATED IN THE UK LETTER TO THE IMF ARE TO BE MET.

8. STERLING SHOWED LITTLE NET MOVEMENT OVER THE WEEK, BUT QUITE A BIT FROM DAY TO DAY. THE POUND STOOD AT \$1.6858
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JUST BEFORE THE CHANCELLOR'S SPEECH DECEMBER 15, AND FELL AFTER THE MINI-BUDGET'S PRESENTATION TO CLOSE IN LONDON AT \$1.6680, WITH SOME BANK OF ENGLAND SUPPORT. ON DECEMBER 17, THIS LEVEL WAS BROKEN AS OPEC DISHARMONY LIFTED THE POUND TO \$1.6710, A GAIN OF 85 POINTS ON THE DAY, AND CONTINUED TO SUPPORT THE POUND THROUGH THE REMAINDER OF THE WEEK. LOWER US INTEREST RATES APPARENTLY LIFTED THE POUND ANOTHER CENT TOWARD THE WEEK'S END.

9. GILT SALES WERE EXTREMELY ACTIVE DURING THE WEEK. THE 15-1/2 PERCENT 1998A TAP STOCK WAS EXHAUSTED ON TUESDAY, MARKET SOURCES ESTIMATING THAT THE BUYING SURGE TOOK 150-200 MILLION POUNDS OF THE GILT FROM THE GOVERNMENT BROKER DURING MONDAY AND TUESDAY. A REPLACEMENT WAS RAPIDLY ANNOUNCED ON DECEMBER 22, THE 15-1/4 PERCENT 1996A, A 750 MILLION POUND ISSUE TO BE PRICED AT 99. THE SHORT TAP, THE 13 PERCENT 1980, WAS ALSO IN DEMAND AS THE GOVERNMENT BROKER SOLD PERHAPS 100 MILLION POUNDS. CHANCELLOR OF THE EXCHEQUER HEALEY IN THE DECEMBER 21 ECONOMIC DEBATE ASSERTED THAT NET SALES OF GILTS DURING THE PAST 3 MONTHS HAD AMOUNTED TO 4 BILLION POUNDS.

10. THE SETTLEMENT OF GILT SALES HAS CREATED A SHORTAGE OF DAY TODAY CREDIT AND THE MONETARY AUTHORITIES HAVE OFFERED CONSIDERABLE ASSISTANCE DURING THE PAST WEEKS REDISCOUNTING TREASURY, LOCAL AUTHORITY AND COMMERCIAL PAPER.

11. EXCHANGE RATE AND GOLD

EFFECTIVE

DATE	EXCHANGE RATE (\$)	DEPRECIATION (PERCENT)	GOLD (\$)
12/15	1.6680	44.4	134-7/8
12/16	1.6625	45.2	133-7/8
12/17	1.6710	44.9	132
12/20	1.6815	44.7	132-1/8

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12/21 1.6805 44.7 133-5/8
CHANGE 12/14-12/21 UP 0.0045 WIDENED 0.1 DOWN 1-3/4

12. FORWARD DISCOUNT ON STERLING

DATE	1 MONTH	3 MONTHS	6 MONTHS
12/15	1.65	4.28	7.55
12/16	1.60	4.28	7.58
12/17	1.50	4.10	7.48
12/20	1.57	4.05	7.45
12/21	1.55	4.08	7.50

CHANGE 12/14-12/21 NAR. 0.02 NAR. 0.12 NAR.0.05
(ALL FIGURES IN CENTS)

13. EURODOLLAR INTEREST RATES

DATE	1 MONTH	3 MONTHS	6 MONTHS
12/15	4-5/8	5	5-1/4
12/16	5	5-1/8	5-3/8
12/17	5-1/4	5-1/8	5-3/8
12/20	4-1/2	5	5-1/4
12/21	4-7/8	5	5-1/4

CHANGE 12/14-12/21 UNCHANGED UNCHANGED UNCHANGED

14. THREE-MONTH LONDON INTERBANK-EURODOLLAR INTEREST
RATE DIFFERENTIAL

DATE
12/15 9-1/2
12/16 9-7/32
12/17 9-7/16
12/20 9-25/32
12/21 9-11/32

CHANGE 12/14-12/21 WIDENED 9/32

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15. STERLING CERTIFICATES OF DEPOSIT

DATE	1 MONTH	3 MONTHS	6 MONTHS
12/15	14-7/8	13-31/32	13-3/32
12/16	15	14-3/32	13-3/8
12/17	14-15/16	14-7/32	13-1/2

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12/20	14-7/8	14-1/4	13-13/32
12/21	14-25/32	14-3/32	13-5/32

CHANGE 12/14-12/21 UNCHANGED UP 7/32 UP 7/32

16. MINIMUM LENDING RATE FELL BY 1/4 PERCENT TO 14-1/2 PERCENT AT THE DECEMBER 17 TREASURY BILL AUCTION. THE AVERAGE TREASURY BILL RATE WAS 13.7568 PERCENT, DOWN 0.2486 PERCENT FROM THE PREVIOUS WEEK. THE 300 MILLION POUNDS OF BILLS TENDERED ATTRACTED BIDS OF 1304.29 MILLION POUNDS. THIS WEEK 300 MILLION POUNDS WILL BE ON OFFER AGAIN, THIS TIME TO REPLACE 600 MILLION POUNDS OF MATURING BILLS.

17. THE GOVERNMENT ANNOUNCED ON DECEMBER 22 THAT IT WOULD EASE THIS YEAR'S FOREIGN EXCHANGE REQUIREMENTS BY

ELECTING TO DEFER PAYMENT OF APPROXIMATELY \$175 MILLION OF INTEREST AND PRINCIPAL ON WAR LOANS OWED TO THE US AND CANADA DUE DECEMBER 31. APPROXIMATELY \$15 MILLION DUE ON PREVIOUS DEFERRALS WILL, HOWEVER, BE PAID.

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